Instructions for Schedule B/C/D/H (100S)

References in these instructions are to the Internal Revenue Code (IRC) as of **January 1, 2005**, and to the California Revenue and Taxation Code (R&TC).

What's New

Dividends Received Deduction – For taxable years beginning on or after January 1, 2008, the allowable dividends deduction percentage increased from 80% to 85% of the qualified dividends received from an insurer subsidiary.

General Information

In general, California law conforms to the Internal Revenue Code (IRC) as of January 2005. However, there are continuing differences between California and federal law. When California conforms to federal tax law changes, we do not always adopt all of the changes made at the federal level. For more information, go to our website at **ftb.ca.gov** and search for **conformity**. Additional information can be found in FTB Pub. 1001, Supplemental Guidelines to California Adjustments, the instructions for California Schedule CA (540 or 540NR), and the Business Entity tax booklets.

The instructions provided with California tax forms are a summary of California tax law and are only intended to aid taxpayers in preparing their state income tax returns. We include information that is most useful to the greatest number of taxpayers in the limited space available. It is not possible to include all requirements of the California Revenue and Taxation Code (R&TC) in the tax booklets. Taxpayers should not consider the tax booklets as authoritative law.

Round Cents to Dollars – Round cents to the nearest whole dollar. For example, round $50.50 up to $51 or round $25.49 down to $25. If the corporation does not round, the Franchise Tax Board (FTB) will disregard the cents. This ~~change~~ helps process your returns quickly and accurately.

Schedules

Schedule B (100S) – S-Corporation Depreciation and Amortization

Use Schedule B (100S) to calculate depreciation and amortization for California purposes.

Important Information

For taxable years beginning on or after January 1, 2005, California does not conform to the federal changes regarding treatment of distribution costs and treatment of participations and residuals for purpose of computing depreciation under the income forecast method.

California law conforms to the federal law changes for start-up and organization expenditures. For start-up and organizational expenditures paid or incurred on or after January 1, 2005, the corporation may elect to deduct up to $5,000 of start-up and $5,000 of organizational expenditures (with limitations) in the taxable year in which the trade or business begins. The remaining expenditures may be amortized ratably over that period of not less than 180 months.

For taxable years beginning on or after January 1, 2005, California law conforms to federal law changes for the useful life of seven years of any Alaska natural gas pipeline property and any motor sports entertainment complex.

Effective January 1, 1998, California law conforms to federal law regarding the income forecast method and the exemption of limits on depreciation for incremental costs of clean fuel vehicles.

California did not allow depreciation under the federal accelerated cost recovery system (ACRS) for years prior to 1987. California also does not allow depreciation under modified accelerated cost recovery system (MACRS) for assets placed in service while the S corporation was taxed as a C corporation. This is a change of accounting method for which the taxpayer must request the FTB's consent.

S corporations must continue calculating the California depreciation deduction for assets placed in service before January 1, 1987, in the same manner as in prior years. The following were the most common methods used to calculate depreciation for years prior to 1987:

- Straight-line
- Declining balance
- Sum-of-the-years digits

For assets placed in service in 1987 and after, S corporations may use the same method for California as was used for federal purposes. S corporations conducting a trade or business inside an Enterprise Zone(EZ), Local Agency Military Base Recovery Area (LAMBRA), or Targeted Tax Area (TTA) may elect to treat a portion of the cost of qualified property as a business expense in the first year it is placed in service. This expense deduction is in lieu of the IRC Section 179 expense deduction. For more information, get form FTB 3805Z, Enterprise Zone Deduction and Credit Summary; form FTB 3807, Local Agency Military Base Recovery Area Deduction and Credit Summary; or form FTB 3809, Targeted Tax Area Deduction and Credit Summary.

California generally conforms to the federal 2003 increase (IRC Section 280F) for the limitation on luxury automobile depreciation. However, California does not conform to IRC Section 168(k) provisions (30% and 50% additional first year depreciation). In addition, sport utility vehicles (SUVs) and minivans that are built on a truck chassis are included in the definition of trucks and vans when applying the 6,000 pound gross weight limit.

Specific Instruction

Part I – Depreciation

Election to Expense Certain Property Under IRC Section 179

The S corporation may elect to expense part of the cost of depreciable personal property used in the trade or business and certain other property described in federal Publication 946, How to Depreciate Property. To do so, the S corporation must have purchased property, as defined in the IRC Section 179(d)(2), and placed it in service during 2008, or have a carryover of unused cost from 2007. If the S corporation elects this deduction, it must reduce the California depreciable basis by the IRC Section 179 expense. The maximum Section 179 expense allowed for 2008 is $25,000.

Complete the worksheet below to figure IRC Section 179 expense for California. Include all assets qualifying for the deduction because the limit applies to all qualifying assets as a group rather than to each asset individually. Refer to federal Form ~~4562 or Form 4562-FY,~~ Depreciation and Amortization, for more information.

Definitions

Listed Property – Use a format similar to federal Form ~~4562 or Form 4562-FY,~~ Part V, line 26 to determine the elected IRC Section 179 cost of listed property. Listed property generally includes the following:

- Passenger automobiles weighing 6,000 pounds or less.

Tangible Property Expense Worksheet

1	Maximum dollar limitation for California	1	25,000
2	Total cost of Section 179 property placed in service	2	
3	Threshold cost of section 179 property before reduction in limitation	3	200,000
4	Reduction in limitation. Subtract line 3 from line 2. If zero or less, enter -0-	4	
5	Dollar limitation for tax year. Subtract line 4 from line 1. If zero or less, enter -0-	5	

	(a) Description of property	(b) Cost	(c) Elected cost
6			

7	Listed property (elected Section 179 cost)	7	
8	Total elected cost of Section 179 property. Add line 6 column (c) and line 7	8	
9	Tentative deduction. Enter the smaller of line 5 or line 8	9	
10	Carryover of disallowed deduction from 2007	10	
11	Enter the smaller of business income (not less than -0-) or line 5	11	
12	Section 179 expense deduction for California. Add line 9 and line 10, but do not enter more than line 11. Also enter the result on Schedule B (100S), Part I, line 5	12	
13	Carryover of disallowed deduction to 2009. Add line 9 and line 10. Subtract line 12 from the result	13	

- Any other property used for transportation if the nature of the property lends itself to personal use, such as motorcycles, pick-up trucks, SUVs, etc.
- Any property used for entertainment or recreational purposes (such as photographic, phonographic, communication, and video recording equipment).
- Cellular telephones (or other similar telecommunications equipment).
- Computers or peripheral equipment.

Exception. Listed property generally does not include:

- Photographic, phonographic, communication, or video equipment used exclusively in the S corporation's trade or business.
- Any computer or peripheral equipment used exclusively at a regular business.
- An ambulance, hearse, or vehicle used for transporting persons or property for hire.

Listed property used 50% or less in business activity does not qualify for the IRC Section 179 expense deduction. For more information regarding listed property, get the instructions for federal Form ~~4562 or Form 4562-FY~~.

Business Income – The total cost the S corporation can deduct is limited to the S corporation's business income. For the purpose of IRC Section 179 election, business income is the net income derived from the S corporation's active trade or business, Form 100S, line 15, before the IRC Section 179 expense deduction (excluding items not derived from a trade or business actively conducted by the S corporation).

Part II – Amortization

California conforms to the IRC Section 197 amortization of intangibles for taxable years beginning on or after January 1, 1994. Generally, assets that meet the definition under IRC Section 197 are amortized on a straight-line basis over 15 years. There may be differences in the federal and California amounts for intangible assets acquired in taxable years beginning prior to January 1, 1994. See R&TC Section 24355.5 for more information.

Amortization of the following assets is governed by California law:

- Bond premiums R&TC 24360 – 24363.5
- Research expenditures R&TC 24365
- Reforestation expenses R&TC 24372.5
- Organizational expenditures R&TC 24407 – 24409
- Start-up expenses R&TC 24414

Other intangible assets may be amortized if it is proved with reasonable accuracy that the asset has an ascertainable value that diminishes over time and has a limited useful life.

Line 2, column (e)

Enter the correct R&TC section for the type of amortization. See the R&TC section numbers listed above.

Part III – Depreciation and Amortization Adjustment

If the S Corporation has direct ownership of a passive activity, complete a separate Schedule B (100S), write "Passive Activity" on the top of Schedule B (100S), and enter the current year depreciation adjustment on Part III. Also, enter the current year depreciation adjustment on form FTB 3801, Passive Activity Loss Limitations, Side 2, California Passive Activity Worksheet, column (e). Make sure to label "Schedule B (100S)" in column (c) of the California Passive Activity Worksheet. Do not enter the current year depreciation adjustment for passive activity on Form 100S, Side 1, line 5.

The corporation does not need to complete Schedule B (100S) for pass-through entities except to include IRC Section 179 expense.

Schedule C (100S) – Corporation Tax Credits

Use Schedule C (100S) to determine the allowable amount of tax credits to claim on the 2008 Form 100S, California S Corporation Franchise or Income Tax Return, and the credit carryover to future years. For more information, see General Information Z, Passive Activity Loss Limitation, AA, Passive Activity Credits, and BB, Tax Credits.

The amount entered in column (a) must be limited to 1/3 the amount of the total credit.

Schedule D (100S) – S-Corporation Capital Gains and Losses and Built-in-Gains

Built-in Gains Tax – For taxable years beginning on or after January 1, 2002, when determining the built-in gains tax, C corporations that were required to convert to S corporations as a result of the enactment of Chapter 35 of the Statutes of 2002, and as amended by Chapter 807 of the Statutes of 2002, for California purposes are deemed to have elected S corporation status on the effective date of their federal election regardless of the effective date for state purposes.

Schedule D (100S) is divided into Section A and Section B. Use Section A to report all built-in gains subject to the 8.84% tax rate (10.84% for financial S corporations). Use Section B to report all other capital gains subject to the 1.5% tax rate (3.5% for financial S corporations). See General Information J, Built-in Gains, for more information.

Use California amounts when computing gain from like-kind exchanges on federal Form 8824, Like-Kind Exchanges.

Section A - 8.84% Tax on Built-in Gains

Part I – Short-Term Capital Gains and Losses - Assets Held One Year or Less and Part II – Long-Term Capital Gains and Losses - Assets Held More Than One Year

S corporations use Part I to report and summarize gains and losses attributable to: (1) sale or exchange of capital assets; and (2) gains on distributions to shareholders of appreciated assets that are capital assets. Be sure to use the California basis for all assets when computing the gain or loss. Get the instructions for federal Schedule D (Form 1120S) for more information.

Line 1 and Line 4

Report short-term or long-term capital gains or losses from form FTB 3725, Assets Transferred from Parent Corporation to Insurance Company Subsidiary, on Schedule D. Make sure to label on Schedule D, line 1 and/or line 4, under column (a) Description of property: "**FTB 3725.**" Enter the amount of short-term or long-term capital gains (losses) from form FTB 3725 on Schedule D, line 1 and/or line 4, under column (f).

Line 2 and Line 5

Use California amounts when figuring the amount to enter for short or long-term capital gains or losses from like-kind exchanges from federal Form 8824.

Part III – Tax on Built-in-Gains

Line 7

To determine if the S corporation is subject to tax on built-in gains, get the instructions for federal Schedule D (Form 1120S) and General Information J, Built-in Gains.

Apportioning corporations only: All recognized built-in gains and all recognized built-in losses apportioned and allocated to California must be included on line 7.

Line 9

Compute the California net unrealized built-in gain reduced by the California net recognized built-in gain from prior years if the S corporation:

- Filed its election to be an S corporation after 1986.
- Was a C corporation before it elected to be an S corporation, or acquired an asset with a basis determined by reference to its basis (or the basis of any other property) in the hands of a C corporation.
- Had a California net unrealized built-in gain as defined in IRC Section 1374(d)(1), that was in excess of the California net recognized built-in gain from prior years.

On line 9, enter the smaller of line 7, line 8, or the amount computed above.

Line 10

For taxable years beginning on or after January 1, 2004, 100% of the NOL may be carried forward. For more information, see form FTB 3805Q, Net Operating Loss (NOL) Computation and NOL and Disaster Loss Limitations — Corporations.

Section B – 1.5% Tax on Capital Gains

Use Section B, Part I and Part II to report the sale or disposition of all capital assets acquired as an S corporation or which are not reported in Section A. For more information, get the instructions for federal Schedule D (Form 1120S).

Property Subject to IRC Section 179 Recapture: Gain on property subject to the IRC Section 179 expense deduction recapture must be included in the taxable income of the S corporation. To accomplish this, the S corporation should complete two sets of Schedule D-1, Sales of Business Property, and Schedule D (100S). One set of Schedule D-1 and Schedule D (100S) will include the gain or loss from the sale or disposition of IRC Section 179 assets as well as gain or loss from non-Section 179 business assets, and will be reported on the Form 100S. Indicate at the top of this Schedule D-1 and Schedule D (100S) "IRC Section 179 and Business Assets." When completing Schedule D-1 and Schedule D (100S) for the 100S, skip any instructions to report the gain or loss on Form 100S, Schedule K or Schedule K-1 (100S).

Transfer the gain amount to Form 100S, Side 1, line 4.

The second set of Schedule D-1 and Schedule D (100S) is to report the gain or loss on non-Section 179 business assets for use on the Schedule K (100S) and Schedule K-1 (100S). To accomplish this, the S corporation should complete a Schedule D-1 and Schedule D (100S) with the gain or loss for the non-Section 179 business assets only. The amounts from this Schedule D-1 and Schedule D (100S) will be reported on the Schedule K (100S) and Schedule K-1 (100S). Indicate at the top of this Schedule D-1 and Schedule D (100S) set "Non-Section 179 Business Assets Only."

Part I – Short-Term Capital Gains and Losses – Assets Held One Year or Less

Line 1

Enter short-term capital gains or losses from form FTB 3725 on Schedule D (100S), line 1. Make sure to label on Schedule D (100S), line 1 and/or line 4 under column (a) and/or column (f). Description of property: **"FTB 3725."**

Part II – Long-Term Capital Gains and Losses – Assets Held More Than One Year

Line 4

Enter long-term capital gains or losses from form FTB 3725 on Schedule D (100S), line 4. Make sure to label on Schedule D (100S), line 1 and/or line 4 under column (a) and /or column (f). Description of property: **"FTB 3725"**.

Schedule H (100S) – S-Corporation Dividend Income Deduction

In *Farmer Bros. Co.* vs. *Franchise Tax Board* (2003) 108 Cal App 4th 976, 134 Cal Rptr. 2nd 390, the California Court of Appeal found R&TC Section 24402 to be unconstitutional. A statute that is held to be unconstitutional is invalid and unenforceable. Therefore, the deduction is not available.

R&TC Section 24410 was repealed and re-enacted to allow a "Dividends Received Deduction" of qualified dividends received from an insurer subsidiary. The deduction is allowed whether or not the insurer is engaged in business in California, if at the time of each payment, at least 80% of each class of stock of the insurer was owned by the corporation receiving the dividend. For taxable years beginning on or after January 1, 2004, and before January 1, 2008, an 80% deduction is allowed for qualified dividends. For taxable years beginning on or after January 1, 2008, the deduction is increased to 85%. A portion of the dividends may not qualify if the insurer subsidiary paying the dividend is overcapitalized for the purpose of the dividends received deduction. See the Schedule H (100S), Part III instructions, for more information.

S corporations may claim a deduction for dividends paid by a corporation taxed by California on earnings from which the dividends are paid.

Part I – Elimination of Intercompany Dividends (R&TC Section 25106)

Intercompany Dividends

Dividends paid to an electing S corporation from earnings and profits accumulated during any taxable year in which the dividend payer was included in the combined report, which included the dividend payee, qualify for the 100% intercompany dividend elimination.

A corporation that has made a valid election to be treated as an S corporation is generally not included in a combined report. However, in some cases, the FTB may use combined reporting methods to clearly reflect income of an S corporation, see R&TC Section 23801(d)(1).

Complete Schedule H (100S), Part I. If no entry in Part III, enter the total from Part I, line 4, column (d) on Form 100S, Side 1, line 9.

Part II – Deduction for Dividends Paid to a Fully Included Member of a Water's-Edge Combined Report (R&TC Section 24411)

Water's-Edge Dividends

California R&TC Section 24411 allows for a 75% deduction of a portion of the dividends received and included in the water's-edge return. For taxable years beginning on or after January 1, 1998, dividends received from banks qualify for the water's-edge dividend deduction. Both business and nonbusiness dividends qualify for the dividend deduction. The allowable business dividend deduction is determined by multiplying the total dividend deduction (business and nonbusiness) by the ratio of business dividends to total dividends. The remaining dividend deduction is the nonbusiness dividend deduction.

A deduction of 100% is provided for dividends derived from certain foreign construction projects. A construction project is defined as an activity attributable to an alteration of land or any improvement thereto. The construction project, the location of which is not subject to the taxpayers' control, must be undertaken for an entity, including a governmental entity, that is not affiliated with the water's-edge group. For more information, see R&TC Section 24411 and Form 100W, California Corporation Tax Booklet — Water's-Edge Filers.

Report the dividends received from certain foreign construction projects in Part II, column (g). Write the dividend payer's name and label dividends received from certain foreign construction projects as "FCP" in Part II, column (a).

In no event will an R&TC Section 24411 deduction be allowed with respect to a dividend for which a deduction was allowed under R&TC Section 24410 or which was eliminated under R&TC Section 25106.

Current year qualifying dividends are dividends received by any current member of the water's-edge group from a corporation (regardless of the place of incorporation) if both of the following apply:

- The average of the payer's property, payroll, and sales factors within the U.S. is less than 20%.
- More than 50% of the total combined voting power of all classes of voting stock is owned directly or indirectly by a member of the water's-edge group at the time the dividend is received.

Interest Expense Deduction

For taxable years beginning on or after January 1, 1997, the amount of interest expense incurred for purposes of foreign investments that must be offset against deductible foreign dividends must be computed by multiplying the amount of interest expense by the same percentage used to compute the deductible portion of the qualifying foreign dividends.

The payer need not be in a unitary relationship with the recipient or any other member of the water's-edge group.

Intercompany dividends received within the current year's water's-edge group should be eliminated pursuant to R&TC Section 25106 before computing the dividend deduction.

Complete Schedule H (100S), Part II and enter the total of line 4 column (g) on Form 100S, Side 1, line 10. For Part II, column (d), if any portion of a dividend also qualifies for the intercompany elimination in Part I, enter the balance from Part I, column (g) in Part II, column (d).

Part III – Deduction for Dividends Paid to a California Corporation by an Insurance Company (R&TC Section 24410)

Dividends Received Deduction

R&TC Section 24410 provides that a corporation that owns 80% or more of each class of stock of an insurer is entitled to an 85% dividends received deduction for qualified dividends received from that insurer. The deduction would be allowed regardless of whether the insurer does business in California. The 85% deduction applies to taxable years beginning on or after January 1, 2008. For taxable years beginning on or after January 1, 2004 and before January 1, 2008 the allowable percentage was 80%.

The amount of the dividends that qualify for the dividends received deduction is the total amount of dividends received from that insurer, multiplied by the insurer's qualified dividend percentage. The qualified dividend percentage is determined under R&TC Section 24410(c).

To complete Part III:

1. Fill in columns (a) through (c).
2. Enter in column (d) the total amount of insurance dividends received.
3. Enter the qualified dividend percentage in column (e).
4. Multiply the amount in column (d) by the qualified dividend percentage in column (e) and enter that amount in column (f).
5. Multiply the amount in column (f) by 85% and enter the result in column (g).
6. Total amounts in column (g).
7. Add amounts from Part I, line 4, column (d) and Part III, line 4, column (g). Enter the result here and on Form 100S, Side 1, line 9.

The calculation of the qualified dividend percentage should be presented in a supplemental schedule that is attached to the taxpayer's return. That schedule should identify the amount of the net written premiums for all the insurance companies in the commonly controlled group for the preceding five years (including an identification of property/casualty premiums, life insurance premiums, and financial guarantee premiums), the relative weight given to each class of net written premiums, and the total income of the insurance companies in the commonly controlled group (including premium and investment income for the preceding five years). For more information, see R&TC Section 24410.